

**Individual Income Tax Return Transactions  
Were Timely and Accurately Recorded  
to Taxpayer Accounts**

**January 2004**

**Reference Number: 2004-40-035**

**This report has cleared the Treasury Inspector General For Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.**



DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

January 2, 2004

MEMORANDUM FOR COMMISSIONER, WAGE AND INVESTMENT DIVISION

*Gordon C. Milbourn III*

FROM: Gordon C. Milbourn III  
Acting Deputy Inspector General for Audit

SUBJECT: Final Audit Report - Individual Income Tax Return Transactions  
Were Timely and Accurately Recorded to Taxpayer Accounts  
(Audit # 200240078)

This report presents the results of our review of the posting of individual income tax return transactions and the subsequent generation of refunds or assessments. The overall objective of this review was to determine whether the Internal Revenue Service (IRS) timely and accurately posted individual income tax return transactions to the Individual Master File (IMF)<sup>1</sup> and timely and accurately generated related refunds or assessments. This audit was the last in a series of audits conducted to review key areas critical to the success of the IRS' 2003 Filing Season.<sup>2</sup>

In summary, we found that the IRS timely and accurately recorded individual income tax return transactions to taxpayers' IMF accounts. We used statistically valid methods to sample return transactions from 1.2 million Tax Year (TY) 2002 individual income tax returns recorded on IMF accounts between January and June 2003. In addition, the IRS timely issued refunds for TY 2002 individual income tax returns, and the refunds were issued in the manner requested by the taxpayer, whether by direct deposit, paper check, or as a credit applied to next year's taxes.

The IRS was not required to respond to this report because it does not include any recommendations. However, IRS management officials reviewed it prior to issuance.

Copies of this report are also being sent to the IRS managers who are affected by the report findings. Please contact me at (202) 622-6510 if you have questions, or

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<sup>1</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>2</sup> The period from January through mid-April when most individual income tax returns are filed.

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs), at (202) 927-0597.

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## Individual Income Tax Return Transactions Were Timely and Accurately Recorded to Taxpayer Accounts

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### Background

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During 2003, the Internal Revenue Service (IRS) processed over 131 million individual income tax returns and issued over \$202 billion in individual income tax refunds. Information from each of these returns must be recorded to the individual taxpayer's account on the IRS' Individual Master File (IMF).

The IMF is the IRS database that maintains the return transactions, which are recorded to individual taxpayer accounts for each tax year. Return transactions are recorded as a debit or credit amount that originates from the tax return. Return transactions include:

- Tax liability.
- Credit for withholdings.
- Overpayment credit applied from prior years.
- Earned Income Tax Credit.
- Estimated tax payments.
- Refund of overpayment.
- Overpayment credit applied to next year.

In order for the IRS to issue correct and timely refunds or balance due notices, the return transactions must be timely and accurately recorded to the IMF.

As part of our overall audit strategy, we have conducted several reviews (see Appendix IV for a listing of these reviews) to assess the IRS' preparation for and processing of individual income tax returns during the 2003 Filing Season.<sup>1</sup> This review is the last in the series of audits conducted to review key areas critical to the success of the 2003 Filing Season.

This review was performed in the IRS' Wage and Investment Division office at its Submission Processing Site in Austin, Texas, from July through November 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in

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<sup>1</sup> The period from January through mid-April when most individual income tax returns are filed.

## **Individual Income Tax Return Transactions Were Timely and Accurately Recorded to Taxpayer Accounts**

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### **Individual Income Tax Return Transactions Were Timely and Accurately Recorded to the Individual Master File**

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Appendix I. Major contributors to the report are listed in Appendix II.

The IRS timely and accurately recorded individual income tax return transactions to taxpayers' IMF accounts. We used statistically valid methods to sample return transactions from 1.2 million Tax Year (TY) 2002 individual income tax returns recorded on taxpayer IMF accounts between January and June 2003. All of the transactions we reviewed were accurately recorded, and all but one transaction was timely recorded.

#### **Refund returns**

We reviewed a statistical sample of 73 individual income tax returns from a population of 949,211 refund returns and found:

- 100 percent of the return transactions were accurate.
- 98.6 percent of the return transactions were timely.

To determine whether return transactions were accurately recorded, we reviewed the returns and identified the specific items that were recorded as return transactions on the taxpayer's IMF account. These included items such as tax liability, tax withholdings, estimated payments, Earned Income Tax Credit, and refund amount.

On 70 of the refund returns reviewed, the transaction amounts recorded to the taxpayer's IMF account matched the amounts reported on the income tax return. In the remaining three instances, there were differences between the amounts reported on the taxpayer's return and the amount recorded on the taxpayer's IMF account; however, in each instance, the difference was a result of either a refund offset<sup>2</sup> or a taxpayer error that had been corrected by the IRS during return processing.

To assess whether the return transactions were timely recorded, we measured the time between the date the IRS received the tax return and the date the return transactions

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<sup>2</sup> The IRS is required to offset or apply a taxpayer's overpayment to any outstanding Federal tax, delinquent child support, Federal agency debt, or state income tax obligation prior to issuing a refund or credit to a future tax obligation.

## **Individual Income Tax Return Transactions Were Timely and Accurately Recorded to Taxpayer Accounts**

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were recorded to the taxpayer's IMF account. We used 40 calendar days as the criteria for determining timeliness.<sup>3</sup> IRS guidelines for timeliness are primarily for the processing of returns at submission processing sites and do not include the overall time needed to record the return transactions to the taxpayer's IMF account. To arrive at the 40 calendar day timeliness criteria, we took the submission processing timeliness criteria of 16 workdays,<sup>4</sup> added 6 calendar days to account for non-workdays, and then added an additional 18 calendar days to account for the IMF processing cycle.<sup>5</sup>

On 72 of the 73 tax returns, the return transactions were recorded on the taxpayer's IMF account within 40 calendar days. The remaining tax return took 45 days to be recorded on the taxpayer's IMF account. The average number of days for the return transactions to be recorded was 25 days.

The sample of 73 refund returns included 43 electronically filed returns and 30 paper returns. All 43 of the electronically filed return transactions were recorded timely and averaged 21 days. Paper return transactions averaged 31 days.

### **Non-refund returns**

We reviewed a second statistical sample of 73 non-refund individual income tax returns from a population of 241,472 returns, and found:

- 100 percent of the return transactions were accurate.
- 100 percent of the return transactions recorded were posted timely.

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<sup>3</sup> This measurement is also the IRS' Customer Service Goal for processing refund returns.

<sup>4</sup> IRS timeliness guidelines are for paper return processing; there are no separate or shorter guidelines for electronic returns.

<sup>5</sup> The IMF processing cycle is the time in which tax return data are received, controlled, and formatted for processing updates to individual taxpayer accounts. This time includes determining whether transactions can be recorded; reconciling debits and credits; updating status; computing, assessing, and abating penalties and interest; and determining account balances or refunds.

## **Individual Income Tax Return Transactions Were Timely and Accurately Recorded to Taxpayer Accounts**

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All return transaction amounts shown on the return either matched the amounts recorded on the taxpayer's IMF account or were properly adjusted to reflect the correct amount. There were six instances in which the amount on the return differed from the return transaction amounts; however, these differences were all due to taxpayer errors that were corrected by the IRS during return processing.

Unlike the refund returns, the non-refund returns are comprised of a variety of return types with different timeliness criteria. Of the 73 returns in the non-refund return sample, 49 were Fully Paid (FP)<sup>6</sup> returns, and 24 were non-refund Other Than Full Paid (OTFP)<sup>7</sup> returns. Because the IRS has different timeliness criteria for processing refund, FP, and OTFP returns, we could not use the same 40 calendar day criteria used in our sample of refund returns.

FP returns are traditionally stored upon receipt and not processed until after the peak processing period has been completed. The IRS assumes that the taxpayer's figures on the return are correct and that notification of a balance due is not necessary. This practice allows the IRS to expedite the processing of time-sensitive refund returns. However, it can increase the number of calendar days it takes to process an FP return. IRS timeliness guidelines simply provide that processing of FP returns at submission processing sites must be completed by July 10. We then accounted for the additional 18 calendar days for IMF processing and considered all FP return transactions processed to taxpayer IMF accounts by July 28 to be timely.

Non-refund OTFP returns have a completion date of May 22 for processing at submission processing sites. When the additional 18 calendar days for IMF processing are included, we considered all non-refund OTFP return transactions timely if recorded to taxpayer IMF accounts by June 9.

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<sup>6</sup> Returns are considered FP when a remittance for the exact amount of balance due reflected on the return is submitted with the return.

<sup>7</sup> The OTFP returns in our sample included balance due, credit elect, even balance, and non-taxable returns.

## **Individual Income Tax Return Transactions Were Timely and Accurately Recorded to Taxpayer Accounts**

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In addition to our reviews for timeliness and accuracy of recording return transactions to taxpayer IMF accounts, we reviewed non-refund returns to determinate whether unpaid taxes were assessed timely on balance due notices. We found that 10 of the 73 returns we reviewed had unpaid balances due and that in each case, the balance due notice was issued timely.

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### **Tax Refunds Were Timely Issued**

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The IRS timely issued refunds for TY 2002 individual income tax returns filed and processed during the 2003 Filing Season. In addition, the refunds were issued in the manner requested by the taxpayer, whether by direct deposit, paper check, or as a credit applied to next year's taxes. Our review of the statistically selected sample of 73 individual income tax returns from the population of 949,211 TY 2002 refund returns filed between January and June 2003 found:

- 98.6 percent of the refunds were issued in 40 days or less.
- 100 percent of the refunds were issued as the taxpayer requested.

The IRS measures refund timeliness as the percentage of refunds from paper returns issued in 40 days or less.<sup>8</sup> The IRS calculates refund timeliness by computing the number of days it takes the taxpayer to receive his or her refund starting 2 days prior to the date the taxpayer's return is received by the IRS through the day the taxpayer receives his or her refund. By computing timeliness in this manner, the measurement is taken from the taxpayer's perspective.

To evaluate the timeliness of our sample of refund returns, we duplicated the IRS' method for computing timeliness. However, because our sample of refund returns was selected to evaluate the accuracy and timeliness in recording return transactions to taxpayers' IMF accounts in addition to refund timeliness, both electronically filed and paper tax returns were included in our measurement. The IRS' timeliness measurement is limited to paper tax returns.

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<sup>8</sup> The IRS does not measure electronically filed returns.

## **Individual Income Tax Return Transactions Were Timely and Accurately Recorded to Taxpayer Accounts**

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In 72 of the 73 returns we reviewed, the refunds were issued in less than 40 days. For 1 return, it took 45 days to issue the refund; no reason for the delay could be identified. Of the 73 returns, 43 were electronically filed tax returns and 30 were paper tax returns. We found that all the electronically filed return refunds were issued within 40 days, and the average refund issue time was 12 days from the return transmission date to the refund received date. For 29 of the 30 paper returns, refunds were issued within 40 days. The average refund issue time for paper returns was 30 days.

In FY 2003, the IRS had a corporate goal for refund timeliness of 98.4 percent. According to IRS data, the FY 2003 refund timeliness measure was 98.8 percent, which exceeded the IRS' goal.

## Individual Income Tax Return Transactions Were Timely and Accurately Recorded to Taxpayer Accounts

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### Appendix I

#### Detailed Objective, Scope, and Methodology

The overall objective of this audit was to determine whether the Internal Revenue Service (IRS) timely and accurately posted individual income tax return transactions to the Individual Master File (IMF)<sup>1</sup> and timely and accurately generated related refunds or assessments. This review was included in our Fiscal Year 2003 Annual Audit Plan for the Wage and Investment Income Programs and is part of our overall strategy to review key areas critical to the success of the IRS' 2003 Filing Season.<sup>2</sup> To accomplish our objective, we:

- I. Determined whether individual income tax returns with refund transactions were correctly posted to the IMF.
  - A. Identified a population of 949,211 Tax Year (TY) 2002 individual income tax returns due refunds included in the IMF 1 Percent Sample File<sup>3</sup> between January and June 2003.
  - B. Selected and reviewed a statistically valid sample of 73 individual income tax returns with refunds, using a 95 percent confidence level, a precision of  $\pm 5$  percent, and a 5 percent expected error rate.
  - C. Reviewed the refund transactions from the statistical sample in I.B to determine whether return transactions were timely and accurately posted to the IMF and that tax refunds were issued timely.
- II. Determined whether individual income tax returns where the tax liability has either been fully paid or has a balance due were correctly posted to the IMF.
  - A. Identified a population of 241,472 TY 2002 individual income tax returns with a zero or balance due tax liability included in the IMF 1 Percent Sample File between January and June 2003.
  - B. Selected and reviewed a statistically valid sample of 73 individual income tax returns with a zero or balance due tax liability, using a 95 percent confidence level, a precision of  $\pm 5$  percent, and a 5 percent expected error rate.
  - C. Reviewed 10 returns from the sample in II.B with outstanding balances due and determined that all taxpayer notices were issued timely.

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<sup>1</sup> The IRS database that maintains transactions or records of individual tax accounts.

<sup>2</sup> The period from January through mid-April when most individual income tax returns are filed.

<sup>3</sup> The IMF 1 Percent Sample File is a snapshot in time of data captured during IMF processing at the Martinsburg Computing Center and contains approximately 1 percent of all transactions recorded to the IMF for the time period covered.

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**Appendix II**

**Major Contributors to This Report**

Michael R. Phillips, Assistant Inspector General for Audit (Wage and Investment Income Programs)

Scott A. Macfarlane, Director

Gary L. Young, Audit Manager

Tina M. Parmer, Senior Auditor

Steven D. Stephens, Senior Auditor

Steven E. Vandigriff, Senior Auditor

Bonnie G. Shanks, Auditor

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**Appendix III**

**Report Distribution List**

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Services and Enforcement SE  
Deputy Commissioner, Wage and Investment Division SE:W  
Director, Customer Account Services SE:W:CAS  
Director, Strategy and Finance SE:W:S  
Director, Submission Processing SE:W:CAS:SP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Management Controls OS:CFO:AR:M  
Audit Liaison: GAO/TIGTA Liaison SE:W:S:PA

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**Appendix IV**

**Listing of Prior Reviews to Assess the Internal Revenue Service's  
Preparation for the 2003 Filing Season**

The following is a list of five 2003 Filing Season<sup>1</sup> reviews that are included in our Fiscal Year 2003 Annual Audit Plan for the Treasury Inspector General for Tax Administration's Wage and Investment (W&I) Income Programs, Customer Account Services business unit. The overall purpose of the reviews was to evaluate the Internal Revenue Service's (IRS) success in planning and executing the 2003 Filing Season. The specific objective for each review is shown below.

***The Internal Revenue Service Has Procedures to Ensure There Is Sufficient Trained Staff to Process Individual Income Tax Returns in 2003 (Reference Number: 2003-40-055, dated February 2003)***

- Overall Objective: To determine whether the IRS' W&I Division has procedures in place to ensure there is a sufficient number of trained staff to process individual income tax returns during the 2003 Filing Season.

***Pre-Filing Season Activities to Address Specific Individual Electronic Filing Issues Were Adequately Conducted (Reference Number: 2003-40-073, dated March 2003)***

- Overall Objective: To determine the state of readiness of the IRS to accept electronically filed individual income tax returns for processing during the 2003 Filing Season. The audit was limited to the activities necessary to ensure the acceptance of electronic returns that may be affected by tax law change provisions relating only to the education and retirement provisions.

***Forms and Publications for the New Education and Retirement Tax Provisions Were Addressed for the 2003 Filing Season (Reference Number: 2003-40-105, dated April 2003)***

- Overall Objective: To determine whether the IRS identified the new tax law provisions that had a significant impact on W&I Division taxpayers and ensured that tax forms, instructions, and publications related to these new provisions were clearly and accurately updated for the 2003 Filing Season. The audit focused on the education and retirement provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA).<sup>2</sup> These provisions

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<sup>1</sup> The period from January through mid-April when most individual income tax returns are filed.

<sup>2</sup> Pub. L. No. 107-16, 115 Stat. 38 (2001).

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could affect an estimated 86.5 million taxpayers<sup>3</sup> by providing tax benefits of up to \$7.6 billion in Fiscal Year 2003.<sup>4</sup>

### ***Computer Programming Requests for the 2003 Filing Season Were Timely Prepared and Generally Accurate (Reference Number: 2003-40-112, dated May 2003)***

- Overall Objective: To determine whether the IRS timely prepared and accurately initiated computer programming requests<sup>5</sup> for new tax law provisions that impact individual income tax return processing during the 2003 Filing Season. The audit focused on those requests for computer programming changes needed to implement the education and retirement provisions in the EGTRRA.

### ***The 2003 Filing Season Was Completed Timely and Accurately, but Some New Tax Law Changes Were Not Effectively Implemented (Reference Number: 2004-40-003, dated October 2003)***

- Overall Objective: To determine whether the IRS timely and accurately processed paper and electronic individual income tax returns during the 2003 Filing Season. The audit focused on the implementation of tax law changes that affected Tax Year 2002 individual income tax returns.

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<sup>3</sup> National Center for Education Statistics, Projections of Education Statistics to 2012, May 2002, and United States Selected Income and Tax Items 1040, 1040A, and 1040EZ, Report Number R-S-92, January – September 2002.

<sup>4</sup> Congressional Budget Office, *Pay-As-You-Go Estimate*, June 4, 2001.

<sup>5</sup> Requests for Information Services.